

maintaining an account relationship, and account billing and collection.

SNI and MTVN also incur certain extraordinary expenses associated with non-cable accounts. For example:

- Additional expenses can arise out of SMATV's inherent vulnerability to subscriber churn.<sup>32</sup> SMATV subscribers tend to move more often than cable subscribers because SMATV subscribers primarily live in apartment buildings rather than other types of residences (such as single family homes), and apartment dwellers move more. Some SMATV properties experience 100% churn per year, a "churn" rate twice as high as cable generally. SNI estimates that the life of an SNI subscriber in a SMATV system is, on average, only 3 to 6 months, as opposed to the 15 to 24 month average estimated for SNI subscribers in a cable system. The shorter lifespan of SMATV subscribers translates into higher marketing costs. The greater mobility of SMATV subscribers translates into bad debt, as such accounts prove to be uncollectible and SMATV operators in turn are less likely to be able to pay the license fees owing to SNI.
- Cable operators report subscriber numbers for billing purposes on an MSO-wide basis, whereas for SMATV operators, SNI must solicit subscriber numbers itself on a property-by-property basis, an expensive and time-consuming process.
- SNI also invested millions of dollars in the Video Cipher II encryption and descrambling system which was necessary to create and serve the HTVRO market.

The contrast is compounded for MTVN. Unlike SNI, where each incremental subscriber produces appreciable subscription revenue, an incremental non-cable MTVN subscriber, as will be explained below, has almost no impact on advertising revenue -- a significant revenue component of those services. Thus, not only

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<sup>32</sup> "Churn" is the term for the percentage of disconnects a premium service experiences in a given time period.

does a non-cable subscriber cost more for MTVN, it simply does not pay to add these subscribers unless MTVN is remunerated through the license fee charged.

- E. The greater financial risk posed by dealing with alternative distribution technologies justifies higher license fee rates

Similarly, Congress has also expressly provided that programmers shall not be prohibited from "imposing requirements for creditworthiness . . . and financial stability." Section 628(c)(2)(B)(i). In the NPRM, the Commission reiterates that programmers are not prohibited from imposing reasonable requirements "to account for differences" in "creditworthiness" and "financial stability" among the distributors to whom they license their services. NPRM at ¶17. Viacom's experience confirms that Congress was correct to recognize that differences are validly made because different customers present different problems that must be addressed by the programmer. As explained below, SNI and MTVN have incurred greater financial risks with non-cable distributors; higher license fees are an appropriate means to protect against that greater risk.

Compared with cable, SNI and MTVN have faced a significantly higher bad debt problem in each of the HTVRO, SMATV and MMDS businesses. The greater financial risk may stem from the fact that it is easier to enter the HTVRO, SMATV or MMDS distribution business than it is to enter the cable distribution business.

For example, to engage in cable distribution, operators must invest in costly plant and equipment, representing significant assets and "staying power," and, significantly, must demonstrate creditworthiness and stability to local franchising authorities. Non-cable technology distributors have much lower start-up costs and are generally not subject to franchising requirements.<sup>33</sup>

Whatever the reasons, SNI estimates that its bad debts, as a percentage of revenue, are approximately seven times higher in SMATV and MMDS than cable, and 14 times higher for certain HTVRO dealers than cable. Put another way, in absolute dollar amounts and excluding HTVRO, cable accounts for approximately 90% of SNI's total revenues, but only 57% of SNI's bad debt; SMATV and MMDS account for approximately 10% of SNI's total revenues, but approximately 43% of SNI's bad debt. In short, SMATV and MMDS (and HTVRO) have had a disproportionately high share of bad debt problems and resulting costs to SNI.<sup>34</sup> MTVN's bad debt

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<sup>33</sup> The failure of SMATV, MMDS and HTVRO distributors to remit monies results in losses at three levels: (1) lost subscription revenue; (2) costs incurred in attempting to collect monies due; and (3) additional costs in the form of payments due to program suppliers whose license fees are based on the number of subscribers, even if SNI or MTVN has not received payment for those subscribers.

<sup>34</sup> An example of the bad debt problem is the bankruptcy of SNI's largest MMDS operator, Microband, and the bankruptcy of Metropolitan Cablevision, another MMDS operator. These two bankruptcies alone account for approximately 10% of SNI's bad debt experience (excluding HTVRO) since 1979. Notwithstanding the history of MMDS bad debt and Microband's and Metropolitan Cablevision's bankruptcies, however, incremental subscribers are still  
(continued...)

experience similarly has been worse with non-cable distributors than with cable operators.

- F. The costs incurred to combat signal piracy in non-cable distribution technologies justify higher license fee rates

As noted above, Congress expressly acknowledged that the programmer is not prohibited from charging different prices to customers if the programmer incurs different costs with different customers. Section 628(c)(2)(B)(ii). Congress also recognized that a programmer could impose requirements (including a higher price) on the distributor to account for differences in the "technical quality" provided by the distributor. Section 628(c)(2)(B)(i).

Historically, signal piracy has posed a greater problem in non-cable technologies, especially the HTVRO market, than in cable. Until recently, industry-wide estimates put the HTVRO piracy level at over 60%. While new (and expensive) scrambling technology may reduce piracy, recoupment of the high additional costs associated with the HTVRO business is an appropriate component of HTVRO license fees.

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<sup>34</sup>(...continued)  
important to SNI and SNI continues to license Showtime and The Movie Channel to Microband.

- G. Non-cable distributors enjoy a lower cost per subscriber to deliver programming signals to the home and thus may undercut cable retail prices, regardless of programming license fee rates

As noted earlier, Section 628(c)(2)(B)(ii) allows a programmer to charge different prices to account for "actual and reasonable differences in the cost of creation, sale, delivery, or transmission of satellite cable programming." As the Commission points out (NPRM at ¶ 17), the legislative history makes clear that Congress intended the FCC to consider the differences in cost not only at the programmer's level, but also at the distributor's level. See 138 Cong. Rec. S16,671 (daily ed. Oct. 5, 1992) (Senator Kerry asked: "Am I correct in understanding that as used in subsection 2(B)(ii) the cost of creation, sale, delivery or transmission of programming refers to costs incurred at the multichannel video programming distributor's level as well as at the program vendor's level?" Senator Inouye responded: "That is correct.").

To the best of Viacom's knowledge, alternative distributors have never declined to license its services because of license fee rates. In light of the statutory purpose of protecting competition rather than competitors, modestly higher license fees to non-cable distributors, where they exist, pose no threat to consumers and to the competitive process because non-cable distributors enjoy favorable cost structures that readily permit

them to meet and undercut cable retail prices even when paying higher license fees.

The following chart identifies and attempts to estimate the capital and operating cost differentials between a typical coaxial cable operation and typical MMDS operation.<sup>35</sup> The analysis assumes there is a 50,000 customer base for each operator, a conservative assumption to the MMDS operator since most do not have subscriber bases of this size. It also assumes that the cable operator is 60% penetrated. All costs are presented on a per customer basis. The operating cost comparison only examines those expenses which have significant variances between the two types of delivery systems.

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<sup>35</sup> This comparison is presented for illustrative purposes. It is not based on cost data from any particular cable or MMDS operator but is an approximation based upon what Viacom Cable believes is reasonably reliable information available to it.

**Comparison of Capital and  
Operating Costs per Subscriber  
for Typical Cable and MMDS Systems**

	<b>Coaxial System</b>	<b>MMDS System</b>	<b>Coaxial Higher (Lower) than MMDS</b>
<b><u>Capital Structure</u></b>			
System Plant/Antenna/Down Converter	\$630	\$200	\$430
Plant Conversion	10	0	10
Connect Costs	60	100	(40)
Headend	20	20	0
Converter/Descrambler	110	110	0
L.O. & P.A. Studios	20	0	20
Bldg/Lshld/ME&O	10	10	0
Total Capital/Customer	<b><u>\$860</u></b>	<b><u>\$440</u></b>	<b><u>\$420</u></b>
<b><u>Operating Expenses/Customer/Month*</u></b>			
Franchise Fees (5% of revenue)	\$1.50	\$0.00	\$1.50
Pole Rental	0.16	0.00	0.16
Power for Cable Plant	0.14	0.00	0.14
Plant Exp (CLI, Maintenance, Service Calls)	1.54	1.02	0.52
Property Tax	0.73	0.15	0.58
L.O./P.A. Support	0.17	0.00	0.17
Subtotal Operating Expenses	<b>\$4.24</b>	<b>\$1.17</b>	<b>\$3.07</b>
Depreciation (Coaxial 10 yr life/8yr MMDS)	<b>\$7.17</b>	<b>\$4.58</b>	<b>\$2.58</b>
Carrying Costs (10% Interest factor)	<b>7.17</b>	<b>3.67</b>	<b>3.50</b>
Total Expenses/Customer/Month	<b><u>\$18.57</u></b>	<b><u>\$9.42</u></b>	<b><u>\$9.15</u></b>

\* These items do not represent expenses which Viacom believes are common to both cable and MMDS operations and which are relatively comparable. They also do not include costs, which are exclusive to MMDS operators, for the leasing of ITFS or OFS frequencies. Viacom does not have a basis for estimating such costs.

While this chart only compares a coaxial cable system with an MMDS system, Viacom believes that cable's cost per subscriber to deliver programming signals to the home is higher than not only MMDS but also other distribution technologies. Capital costs represent the bulk of this disparity because cable operators must invest in and periodically upgrade plant and equipment for each of their systems. This includes the construction of headends and laying coaxial cable or optical fiber. Cable operators generally are required to wire entire franchise areas, regardless of how many homes in a particular area might actually subscribe to any cable services, and may incur extraordinary construction costs in doing so because of building schedules imposed by municipalities. Cable operators also incur costs in obtaining and renewing franchises, and must pay pole attachment fees and/or duct rental fees and considerable franchise fees to local municipalities (up to 5% of gross revenues) for the privilege of doing business in a specified area. Historically, cable operators often must, as a condition of being granted a franchise, provide other incidental services at significant cost (for example, providing channel space, studios and facilities for PEG programming, wiring local fire houses, libraries and public schools and providing them with free service, establishing community endowments and the like).

By contrast, the equipment at a SMATV headend is generally less expensive than at a cable headend (due, in part, to smaller



signal capacity offered and fewer dishes per headend). Since SMATV headends are located at the property, less cable and ancillary equipment is required to reach each subscriber, and only actual subscribers need be wired. Similarly, a less expensive coaxial cable can be used because of the fewer channels offered by SMATV and because the wiring is generally not exposed to the elements. For MMDS, only equipment at the headend and the subscriber's home must be put in place; no wiring of any sort is required to link the two. Unlike in cable franchises, where the operator usually is required to wire an entire franchise area, both MMDS and SMATV operators are free to service only those properties and locations which they expect to be highly profitable.

Similarly, the per subscriber cost to deliver a signal to the home for HTVRO distributors is significantly less than cable. Most HTVRO distributors have no plant or hardware costs because the cost of the receiver (the satellite dish) -- the counterpart to the cable operators' headend -- usually is paid by HTVRO subscribers. HTVRO distributors have no transponder or uplink costs, nor do they have scrambling-related costs because the subscriber purchases and owns the decoder. Their sole major costs are advertising and their telephone center for receiving orders and transmitting requests for authorization to receive descrambled signals.

SMATV, MMDS and HTVRO distributors do not incur the imbedded regulatory costs of cable operators and almost never pay pole attachment fees, duct rental fees, franchise fees or related costs. These distributors also benefit from the free ride on cable operators' years of marketing efforts and promotional expenditures that have built up the brand awareness and popularity of the whole range of satellite-delivered program services. Many of the program services which are now sold through alternative distribution technologies were established as viable and attractive services largely through the efforts of cable operators which heavily marketed these services to consumers. Cable operators continue to spend substantial funds on marketing program services to maintain consumer awareness of the desire for these services. Non-cable distributors need not incur comparable marketing costs because the popularity and legitimacy of the program services they sell have already been established, largely through the efforts of the program services themselves and also through the continuing efforts of cable operators.

Accordingly, because of these cost advantages, SMATV, MMDS and HTVRO distributors are able to undercut cable's retail prices to subscribers even where such alternative distributors are charged higher license fees. For example, at the retail level, HTVRO subscribers to an attractive program package (e.g., two premium services plus about 25 other satellite-delivered

services) typically pay significantly less for their programming package than cable subscribers pay for a comparable program package. An HTVRO subscriber may pay as little as \$23 to \$33 per month (when paid on an annual basis) for such a package, whereas a typical cable subscriber would pay \$35 to \$40 per month for a comparable package, and even more in major metropolitan areas.

Thus, because of their lower operating costs, it is unlikely that non-cable distributors will be able to demonstrate competitive injury as a result of any price disparity.

H. Because cable operators have market power in their local markets, their license fees are not an appropriate benchmark for non-cable rates

As the Commission and Congress have noted, relatively few non-cable distributors have heretofore existed so as to provide access to viewers for satellite-delivered program services. Indeed, a basic premise of the Act is that cable operators have market power and have exercised their leverage as the virtually sole providers of program services to consumers. Thus, if a program service desired access to potential subscribers in a particular geographic area, it had no choice but to deal principally with a single cable operator. Not surprisingly, because they controlled access to consumers, cable systems typically obtained low rates in return for carriage or their agreement to push subscriber growth. Notwithstanding the entry of new technologies, cable operators still control access to the

overwhelming number of subscribers and use the bargaining power this creates to obtain low license fees from program services.<sup>36</sup>

Consequently, SNI's cable license fees for its premium services and MTVN's cable fees for its advertiser-supported services have been set at artificially low levels. Their rates to non-cable distributors are a reflection of Viacom's reasonable attempt to be profitable in an environment that is not skewed by the control cable operators historically have exercised over access to consumers.

Viacom's rates to non-cable distributors are not designed to inhibit the development of these technologies. Indeed, it is in Viacom's long-term interest as a programmer to stimulate the growth of these technologies. However, the fact that Viacom might benefit from the existence of additional distribution sources does not mean Viacom should be required to subsidize them.

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<sup>36</sup> Moreover, not only are cable systems often the only alternative in a particular locality, but even in instances in which there is competition, the local cable operator often is the only entity with the large subscriber base that the programmer must reach to ensure the viability of both advertiser-supported and premium services. Thus, the programmer must sell its programming to the cable operator in order to be a viable entity.

III. Conclusion

For the reasons set forth above, Viacom submits that it is critical for the Commission to exercise care to fashion its implementing regulations in a way that will not foreclose pro-competitive marketplace activities that do not conflict with the fundamental objectives of the Act.

Respectfully submitted,

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